

Letter of Findings Number: 05-0519
Income Tax
For Tax Years 2001-03

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ISSUE

I. Income Tax–Combined Return

Authority: IC § 6-3-2-2; IC § 6-8.1-5-1; [45 IAC 3.1-1-62](#)

Taxpayer protests the Department's decision to force a combined return.

STATEMENT OF FACTS

Taxpayer has retail operations in Indiana and throughout the United States, along with affiliated companies in related businesses. Taxpayer has numerous subsidiaries and filed a separate Indiana tax return for those subsidiaries with physical locations in the state. As the result of an audit, the Indiana Department of Revenue ("Department") used the best information available to determine that taxpayer must discontinue filing separate returns and must file a combined return in order to fairly reflect Indiana income. As a result, the Department also issued proposed assessments for additional corporate income tax for the years in question. Taxpayer protests the proposed assessments and the determination that it should file combined returns. Further facts will be supplied as required.

I. Income Tax–Combined Return

DISCUSSION

Taxpayer protests the determination that it must file combined income tax returns and the associated proposed assessments. Due to sales of credit card accounts from taxpayer's retail operations to another subsidiary, the Department determined that taxpayer should file combined returns to properly reflect Indiana-source income. The Department determined that the sale of the credit card accounts resulted in an understatement of Indiana-sourced income, since the subsidiary buying the accounts did not file Indiana income tax returns. In support of its position, the Department referred to IC § 6-3-2-2(l), which states:

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;
- (2) the exclusion of any one (1) or more of the factors;
- (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The Department determined that, since IC § 6-3-2-2(l)(4) allows the employment of any method other than the standard allocation and apportionment provisions of IC § 6-3-2-2 to effectuate an equitable allocation and apportionment of taxpayer's income, combined filing was the appropriate method to use in this case. The Department determined taxpayer's apportionment factors and the tax due under combined filing incorporating all subsidiaries in the taxpayer's federal combined filing group.

Taxpayer protests that the sales of the credit card accounts were always conducted at arm's-length, and that the Department's determination that a combined return was necessary was incorrect. Taxpayer argues that the Department's reliance on IC § 6-3-2-2(l)(4) was premature, since the Department did not attempt to use any other method available under IC § 6-3-2-2. Taxpayer refers to [45 IAC 3.1-1-62](#), which states:

All corporations doing business in more than one state shall use the allocation and apportionment provisions described in Regulations 6-3-2-2(b)-(k) [[45 IAC 3.1-1-37](#) - [45 IAC 3.1-1-61](#)] unless such provisions do not result in a division of income which fairly represents the taxpayer's income from Indiana sources. In such case the taxpayer must request in writing or the Department may require the use of a more equitable formula for determining Indiana income. However, the Department will depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute income to this state or other states. It is anticipated that these situations will arise only in limited and unusual circumstances (which ordinarily will be unique and nonrecurring) when the standard apportionment provisions produce incongruous results.

Taxpayer asserts that the Department has not satisfied the provision of [45 IAC 3.1-1-62](#) which states that, "[T]he Department will depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute

income to this state or other states."

A review of the audit report shows that the Department was acting under time constraints and did not have all of the information it believed necessary to conduct an audit to its full satisfaction. The Department therefore concluded the audit based on the best information available in the time available. The audit report does not provide a detailed explanation of why standard reporting procedures were inadequate, nor does the report provide details explaining why a combined filing is necessary. Rather, the Department offers only a cursory explanation of the relationship between the subsidiaries, and then concludes that combined filing is required.

As part of this protest process, taxpayer has submitted substantial documentation in support of its position that separate filing is appropriate and combined filing is not necessary. A review of this information shows that, while the subsidiaries are in a unitary relationship, they conducted all of their business at arm's-length. The documentation also shows legitimate business reasons for the sale of the credit card accounts. Under IC § 6-8.1-5-1(b), the burden of proving a proposed assessment wrong rests with the person against whom the assessment is made. In this case, taxpayer has provided sufficient documentation to meet the burden of proving the assessment wrong.

Taxpayer also protests the inclusion of the sale of the credit card and financial business as business income. In the course of creating the combined filing assessments, the Department included a significant amount of income from taxpayer's sale of the credit card and financial products business to an unrelated party. Taxpayer protests that this is non-business income and should be allocated to the state where the credit card and financial products business was located. Since taxpayer has already met its burden of proving that it does not need to file a combined return, and since the credit card and financial products business is not included in the separate filing, there is no need to address this issue beyond this discussion.

In conclusion, since the documentation provided by taxpayer establishes legitimate business reasons for the actions of the various subsidiaries, and since the documentation also shows that the transactions were conducted in a manner consistent with industry standards, taxpayer has rebutted the Department's rationale for requiring a combined return. [45 IAC 3.1-1-62](#) establishes that the Department will depart from the standard formula only if it is necessary to fairly allocate and apportion a taxpayer's income to Indiana. A review of the information currently available to the Department shows that such a departure is not necessary. Taxpayer has met the burden of proving the assessment wrong, as provided by IC § 6-8.1-5-1(b).

FINDING

Taxpayer's protest is sustained.

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